MANAGEMENT OF THE PUBLIC DEBT

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

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MANAGEMENT OF THE PUBLIC DEBT

TUESDAY, APRIL 27, 1982

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10:10 a.m., pursuant to notice, in room 1100, Longworth House Office Building, the Honorable J. J. Pickle presiding.

[The press release announcing the hearing follows:]

[Press Release of Monday, Apr. 19, 1982]

HON. DAN ROSTENKOWSKI, CHAIRMAN, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A 1-DAY PUBLIC HEARING ON THE ADMINISTRATION'S PROPOSALS RELATING TO THE MANAGEMENT OF THE PUBLIC DEBT

The Honorable Dan Rostenkowski (D., Illinois), Chairman of the Committee on Ways and Means announced today that the Committee on Ways and Means will hold a one-day public hearing, on Tuesday, April 27, 1982, on the Administration's proposals relating to the management of the public debt. The hearing will begin at 10:00 a.m. in Room 1100 of the Longworth House Office Building.

The Administration has proposed that limitations on savings bond interest rates be removed to link the interest rate on savings bonds to market rates of interest. The Administration has also proposed that the interest rate limitation on long term bonds be repealed.

In announcing this hearing, Chairman Rostenkowski stressed that issues involving changes in the level of the public debt limitation will not be considered at this time. Such testimony will only be taken after a formal request for an adjustment in the ceiling is received from the Administration .

The Committee will hear testimony from Administration officials, Members of Congress and public witnesses who have requested to be heard.

A. SAVINGS BOND INTEREST RATE

Under present law the Administration has discretionary authority to increase the maximum rate of interest on savings bonds by not more than 1 percentage point in any six-month period. The savings bond rate was most recently increased, to 9 percent, on May 1, 1981. The Administration has proposed that this limitation be repealed to permit interest rates on savings bonds to be limited to market rates of interest. Holders of savings bonds would be guaranteed minimum rates which would gradually rise through the first five years after purchase. All bonds held for longer than five years would earn interest at a rate equal to 85 percent of the average market yield on five-year Treasury securities during the holding period, or the guaranteed minimum rate, whichever is higher. Existing savings bonds held for an additional five year period would also be eligible for interest payments under the new system. All other features of savings bonds—including denominations, deferral of tax on accelerated interest, and payroll savings plans—would remain the same.

B. LONG TERM BOND INTEREST RATE

Under present law, there is a $70 billion limit on the outstanding volume of privately held, marketable bonds (securities with a term to maturity of 10 years or more when issued) that carry an interest rate in excess of a 4¼ percent statutory

ceiling. The Administration has proposed that the 4¼ percent statutory ceiling be repealed.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Requests to be heard must be made by telephone to Ms. Harriett Lawler, telephone (202) 225-3627, by the close of business, Friday, April 23, 1982. The telephone request should be followed by a formal written request addressed to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515.

The following is an outline of the procedure to be followed by organizations and individuals who either may want to appear and testify during this hearing or file a written statement for the printed record of the proceedings. All requests should contain the following information:

1. The name of the witness, his title, address, firm affiliation and/or organization he will represent (as well as a telephone number where he or his designated representative may be reached).

2. If appearing in an individual capacity, a list of any clients at whose request or in whose employ the witness appears.

3. A topical outline or summary of comments and recommendations.

Witnesses are required to submit 125 copies of their prepared statements to the Committee office, room 1102 Longworth House Office Building, at least 24 hours in advance of the hearing. Failure to comply with this rule may result in the witness not being allowed to testify.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

For those who wish to file a written statement for the printed record of the hearing, five copies (5) are required and must be received by the close of business, Friday, April 30, 1982. These statements should contain the information listed in #1-3 earlier in this press release. The statements should be delivered to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. An additional supply of statements for the printed record may be furnished for distribution to the press and public if supplied to the Committee office before the hearing begins.

Mr. PICKLE. The committee will come to order. If members will take their seats we will proceed. Chairman Rostenkowski is literally in the air. We think he will be here shortly. In an effort to get the hearing underway, we will proceed and I will make the chairman's opening statement.

This morning's hearing is devoted to two administration proposals related to the management of the public debt. We will not be considering any increase in the debt ceiling. The committee awaits a request from the administration to raise the debt ceiling by some specific amount.

The first proposal relates to the savings bond program. The administration has proposed that the limitation on savings bond interest rates be removed so that savings bonds could be issued varying the rate of interest linked to market rates. The second proposal is to remove the limitation on interest rates paid on long-term bonds.

Our first witness is Angela Buchanan, Treasurer of the United States. We are very pleased to have you here this morning, Ms. Buchanan, and we will be pleased to have your testimony.

STATEMENT OF HON. ANGELA BUCHANAN, TREASURER OF THE UNITED STATES AND NATIONAL DIRECTOR, U.S. SAVINGS BONDS DIVISION, DEPARTMENT OF THE TREASURY

Ms. BUCHANAN. Thank you, Mr. Chairman. It is my pleasure to be here today to discuss the Department's request for legislation to repeal the interest rate ceiling on savings bonds. It is the opinion

of the Treasury that such legislation is in the best interest of the American public, in the best interest of the Federal Government, and that such legislation is long overdue.

The main issue, Mr. Chairman, is tens of millions of American families, people from all walks of life, who purchase savings bonds each year. These individuals, generally small savers, have found over the years that savings bonds have provided them a safe, convenient means by which to save. The payroll savings plan, in particular, has allowed savings to become automatic. Withholding money directly from their paychecks is for many the only means by which they can save.

Increasing savings is of major importance to this Nation's economic recovery. Savings bonds encourage thrift by their convenience, and provide an instrument to the saver who is not often courted by the financial institutions.

But in the last several years market rates have significantly outpaced the rate on savings bonds and legislation prevented Treasury from reacting appropriately. The millions of Americans holding savings bonds have not been given a fair rate of return in these years of high interest rates and, consequently, the program has suffered.

The savings bonds program was never intended to be an aggressive competitor with the private financial sector on an interest rate basis. Nor was it intended to be placed for short-term money. Its aim has simply been to provide an easy, continuous way to save for millions of people who find saving difficult. Nevertheless, it is the responsibility of the Government to make the rate paid to these savers a fair one. The proposal before us today does just that.

In addition, Mr. Chairman, the Government benefits. Savings bonds are the most stable means the Treasury has to finance the debt. The $67 billion of outstanding savings bonds is $67 billion that the Government does not need to compete for in the open market. Furthermore, these funds are cheaper than those of the marketable debt.

If Treasury is to continue to enjoy these benefits, the instrument must be improved, so that redemptions of savings bonds are reduced and sales increased. The flexibility that we seek through this legislation will allow Treasury to provide a fair and reasonable instrument benefiting both the Government and the saver.

If this legislation were to become law, the Treasury Department is ready to offer those individuals who hold savings bonds for at least 5 years no less than 85 percent of the average return on 5-year Treasury marketables during their holding period. This rate would also apply to bonds purchased prior to the enactment of the bill if they are held for 5 years from the date of enactment. In addition, there will be a minimum rate, thereby creating a floor below which the return on savings bonds would not fall.

Mr. Chairman, the small saver deserves a fair deal from his Government. It is for this reason that we request this legislation.

This concludes my remarks. Mr. Mark Stalnecker, Deputy Assistant Secretary of the Treasury for Federal Finance, will at this time discuss this proposal from the point of view of debt management. At the conclusion of his remarks we would both welcome any questions you or the committee might have.

Mr. PICKLE. Would you identify the gentleman whom you refer to?

Ms. BUCHANAN. Sir, he is right here on my left.

Mr. PICKLE. Your name, sir?

Mr. STALNECKER. My name is Mark Stalnecker. I am Deputy Assistant Secretary of the Treasury.

Mr. PICKLE. All right, Mr. Stalnecker, we will receive your remarks. Mr. Stalnecker, will you summarize your statement? I see you have a full statement here.

Mr. STALNECKER. I had planned to——

Mr. PICKLE. Your entire statement will be included in the record.

Mr. STALNECKER. I have planned to read almost the entire statement. It refers not only to savings bonds but also the administration's proposal on the repeal of the interest ceiling on marketable bonds.

Mr. PICKLE. All right.

STATEMENT OF HON. MARK E. STALNECKER, DEPUTY ASSISTANT SECRETARY OF THE TREASURY (FEDERAL FINANCE)

Mr. STALNECKER. Mr. Chairman and members of the committee, it is a pleasure to be here to discuss, from a debt management perspective, the Department's requests for legislation to repeal the interest rate ceilings on savings bonds and on Treasury marketable bonds.

I would like to state at the outset that this administration abhors interest rate ceilings as ineffective attempts to control prices and incompatible with our commitment to a free market pricing system. We view these particular interest rate ceilings as anachronisms which serve only to frustrate the efficient management of the public debt.

First, I would like to comment on savings bonds. For most of the past 45 years the savings bonds program has been a relatively stable source of funds, financing a significant portion of the public debt. The program broadens the market for Government securities and the cash raised by savings bonds reduces the amount of borrowing that the Treasury must undertake on a competitive basis in the open market. The relatively long maturity of savings bonds helps with Treasury's current objective of achieving a better maturity structure of the public debt. Also, savings bonds have proved to be a cost-effective means of financing the debt, with ultimate savings to the American taxpayer.

The program generally has been popular with the American people, has helped instill a habit of thrift among small savers, and has received broad support from leaders of industry and finance. Yet the future role of the savings bonds program in financing the public debt will depend primarily on the interest rate on savings bonds relative to rates on competing instruments.

Sales of savings bonds increased dramatically in the 1970's, from about $4.8 billion in 1970 to a post-World War II peak of $8 billion in 1977 and 1978, and sales exceeded redemptions by $1.5 billion in the period 1970–77. However, as market rates of interest began to increase in 1978, redemptions began to exceed sales, and, as shown

in chart 1 attached to my statement, there has been a substantial cash drain from the Treasury each year since 1978.

Legislation enacted in October 1980 authorized Treasury to increase the interest rate on savings bonds by up to 1 percent during any 6-month period. Accordingly, Treasury increased the maximum rate on savings bonds from 7 percent to 8 percent on November 1, 1980, and to 9 percent on May 1, 1981. Yet the maximum rate increases permitted under existing law have not been sufficient to stem the savings bond cash drain from the Treasury, because of higher interest rates available from other market instruments. Savings bond redemptions exceeded sales by over $5 billion in 1979, over $11 billion in 1980, nearly $9 billion in 1981, and by $2 billion in the first 3 months of 1982.

This substantial cash drain from the savings bond program—$27.8 billion since 1978—must be financed by other, more expensive, Treasury borrowing, namely the issuance of additional marketable securities at interest rates much higher than the savings bond rate. Interest rates on Treasury marketable intermediate notes and bonds are currently around 13¾ percent, compared to the current guaranteed rate of 9 nine percent paid to series EE bond holders after 8 years.

To stem the cash drain, Treasury must assure savings bond investors that they will receive a fair rate of return throughout their holding period. Thus, Treasury must be able to promise the small saver that the rate on savings bonds will vary with market rates of interest. Large investors can achieve this assurance through investment in short-term Treasury bills.

The alternative of raising the savings bond rate to, say, 10 percent now and possibly a higher rate later, under existing legislation, was rejected by Treasury. While such rate increases might over time reduce the savings bond cash drain, they would be relatively expensive over the long run if market rates of interest declined. In this regard, savings bonds differ from long-term marketable debt. Holders of marketable securities do not have the option of redeeming their securities at par, and thus bear market risk not borne by savings bond investors. Also, there is no way under existing legislation that Treasury could assure long-term savers that the rate on savings bonds would continue to be competitive with current market rates. The need is for a savings bond rate that automatically increases and decreases with market rates, and that is what we propose.

Simply stated, the major change will be that people holding either new or old bonds for at least 5 years from the beginning of the new program will be assured that their return will be no less than 85 percent of the average return on 5-year Treasury marketables during their holding period. They will also be guaranteed a minimum rate. So they will receive 85 percent of the average market yield on 5-year Treasury securities over the holding period, or the guaranteed minimum rate, whichever is higher. Five-year Treasury marketable securities currently are yielding about 13¾ percent. If this rate prevailed over the holding period, the savings bond rate would be 11.7 percent.

The rate paid on savings bonds must be less than the marketable rate for several reasons. One, savings bonds are available in small-

er minimum denominations and therefore entail higher administrative costs. Two, savings bonds have tax deferral advantages which increase their effective yield after taxes relative to marketable securities. And three, savings bonds are redeemable at par, thereby eliminating the risk of market value depreciation inherent in ownership of marketable Treasury notes. On this basis, a rate on savings bonds equal to 85 percent of the rate on marketable Treasury 5-year notes is a fair rate of return.

A healthy savings bonds program is not only good for small savers. It is good for the Treasury, too. Even at the higher market-related rates we propose to pay to savings bond holders, the costs to the Treasury will be less than the alternative cost of financing this debt in the open market. Thus, the longer we delay the introduction of the new variable rate savings bond the greater the cost of financing the debt.

Now I would like to turn to the other proposal being considered today. That is the repeal of the interest ceiling on marketable Treasury bonds.

The maximum interest rate that the Treasury may pay on marketable bonds has long been limited by law to 4¼ percent. This limit did not become a serious obstacle to Treasury issues of new bonds until the mid-1960's. At that time market rates of interest rose above 4¼ percent and the Treasury was precluded from issuing new bonds. The average length of the privately held marketable debt of the Treasury declined steadily from 5¾ years in mid-1965 to about 2½ years in 1975, because of the heavy reliance by the Treasury on short-term bill financing of the large budget deficits during this period. Chart 2 attached to my statement indicates this change.

Congress first granted relief from the 4¼-percent ceiling in 1967 when it redefined, from 5 to 7 years, the maximum maturity of Treasury notes. Since Treasury note issues are not subject to the 4¼-percent ceiling on bonds, this permitted the Treasury to issue securities in the 5- to 7-year maturity area without regard to the interest rate ceiling. In the Debt Limit Act of March 15, 1976, the maximum maturity on Treasury notes was increased from 7 to 10 years. Today, therefore, the 4¼-percent ceiling applies only to Treasury issues with maturities in excess of 10 years, and certain amounts, such as bonds held by the Federal Reserve and Government accounts, have been exempted from this ceiling.

In 1971 Congress authorized the Treasury to issue up to $10 billion of bonds without regard to the 4¼-percent ceiling. In 1973 Congress relaxed the $10 billion limit by applying it only to private holdings. The dollar limit since has been increased from time to time, most recently on October 3, 1980, when the limit was raised to $70 billion to accommodate additional long-term financing.

Since 1975 the Treasury's debt extension policies have moved the average length of the marketable debt from 2 years, 5 months in January 1976 to just over 4 years in March 1982, thus reducing the administrative burden and the market-disrupting impacts of frequent Treasury operations to refund maturing issues. Yet while the Treasury has significantly improved the maturity structure of the debt in recent years, almost one-half of outstanding marketable debt matures within 1 year. This refunding need must be added to

Treasury's new cash borrowing requirement to determine gross Treasury issuance in the market. Because of the short average maturity of outstanding Treasury debt, long bond issuance must remain an integral part of Treasury's debt management policy.

Some observers have suggested that Treasury should avoid the sale of long-term securities when interest rates are "high," in order to avoid locking in "high" interest rates. However, any definition of high interest rates is extremely subjective and carries with it an implicit forecast of future interest rates. If Treasury "temporarily" withdrew from the bond market because it felt rates were "high," market reaction to reentry in the long market could well be that rates were "low." Thus, reentry could be interpreted as a Government forecast of higher rates in the future. Management of the debt based on interest rate forecasts such as these would create tremendous uncertainty as to Treasury's financing schedule and, over the long run, would result in higher costs to the Government by reducing the market's willingness to bid in auctions. Therefore, a consistent policy of debt issuance across the maturity spectrum must be maintained without regard to expected interest rate developments.

I would also note that, because of the large volume of maturing obligations refinanced each year, interest expense on the public debt is extremely sensitive to interest rate movements. This adds volatility to the interest expense component of Federal outlays. As interest rates move up and down, Treasury's interest expense also rises or falls. As long as the debt outstanding retains this short-term character, debt extension must be a part of our debt operations.

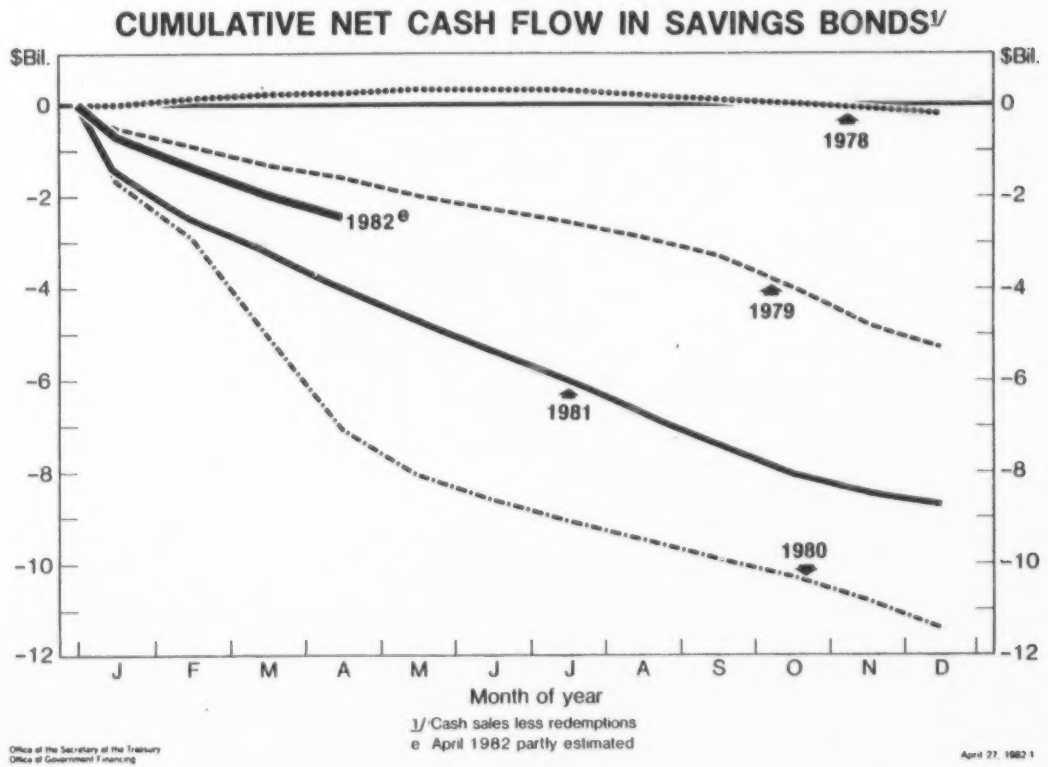
At this point I would like to note that market uncertainty has recently arisen because of our inability to sell long-term bonds due to the 4¼-percent ceiling. As I mentioned earlier, the face amount of Treasury bonds held by the public with interest rates in excess of 4¼ percent may not exceed $70 billion. Treasury has exhausted this authority. Unless Congress repeals the 4¼-percent ceiling or grants additional issuing authority, no more bonds may be sold. In fact, Treasury was forced to cancel its regular auction of 20-year bonds last month, and would normally announce its regular auction of 30-year bonds as part of our refinancing package tomorrow. We cannot do so because of congressional inaction. Inability to sell these securities has created dislocations in the market and raised questions about the Treasury's ability to carry out predictable, prudent debt management policies. I urge Congress to expedite the long bond authority legislation so that this uncertainty can be resolved.

In conclusion, Mr. Chairman, we face large borrowing requirements over the foreseeable future. A viable, modern savings bond program and removal of the 4¼-percent ceiling on Treasury marketable bonds will help the Treasury to meet these financing needs in an efficient, cost-effective manner. Interest on the public debt is estimated to total a record $116 billion in this fiscal year. We must make every effort to reduce this staggering cost to the taxpayer. Especially at this time of severe budget stringency, we must not add to our budget costs by mismanaging the public debt.

That completes my full presentation and, of course, I would be more than happy to answer any questions that anyone has.

[Attachments to the prepared statement follow:]

Chart 1


CUMULATIVE NET CASH FLOW IN SAVINGS BONDS1/
$Bil.
0
-2
-4
-6
-8
-10
-12
1978
1982e
1979
1981
1980
J
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S
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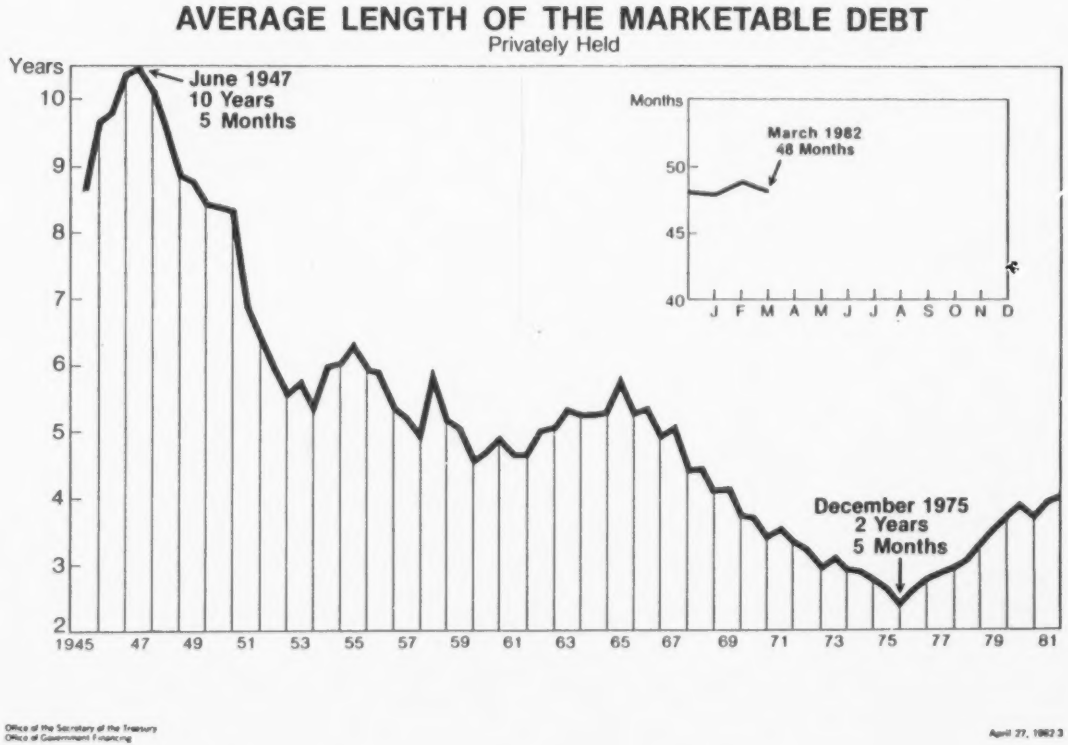
Month of year
1/ Cash sales less redemptions
e April 1982 partly estimated
Office of the Secretary of the Treasury
Office of Government Financing
April 27, 1982-1

Chart 2



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Office of Government Financing

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Chart 3

USE OF AUTHORITY TO ISSUE TREASURY BONDS WITH INTEREST RATE OVER 4¼ PERCENT

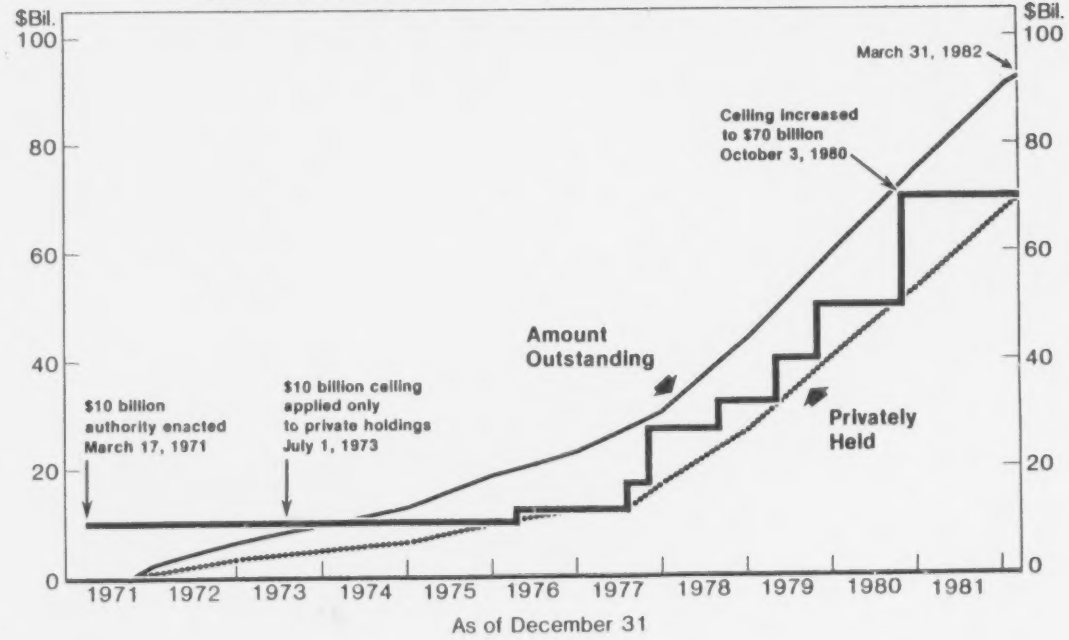

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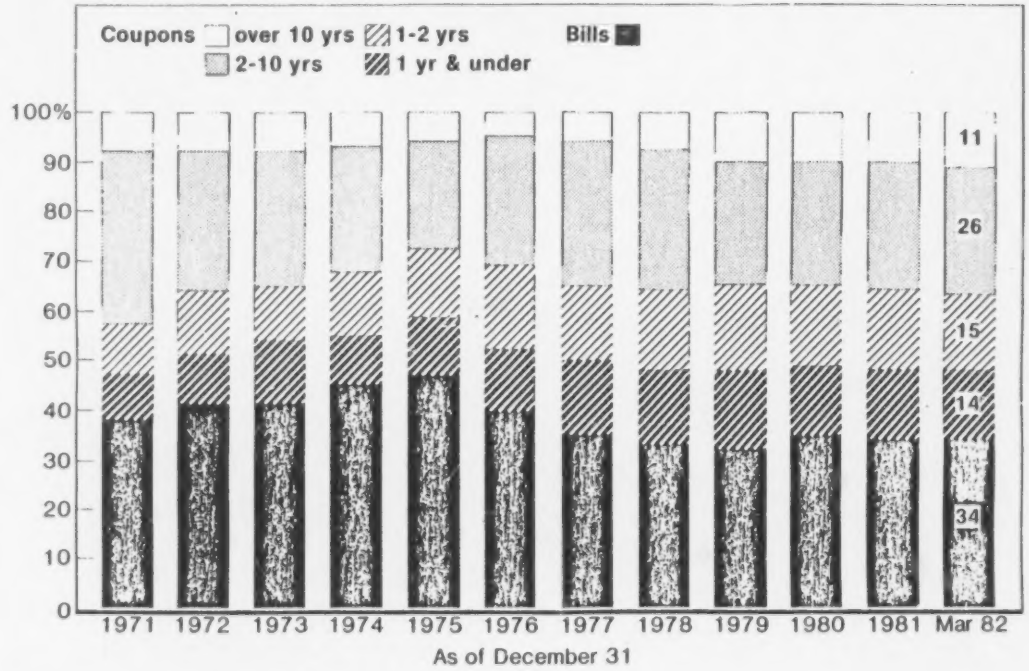
Chart 4

PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT BY MATURITY



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Chairman ROSTENKOWSKI. Are there any questions of Mr. Stalnecker?

Mr. CONABLE. I would just like to get the figures again, sir, to be sure I have them in mind. How many outstanding bonds do we have at the present time? You mentioned that $2 billion had already been redeemed beyond sales this year and that something like $9 billion had been redeemed last year.

I assume, then, that we have had an increasing decline in the number of outstanding savings bonds, the aggregate amount, and I want to get that firmly in mind. I assume, we have given the American people a rather poor deal on this. I assume the reason we have not cut savings bond interest loose before is because we were trying to give the taxpayers a better deal.

But evidently the American people have become increasingly sophisticated and do not want to be treated in this way. They are, therefore, redeeming in excess of purchasing. Now many people do not look at this as an investment program but as a forced savings program. If they look at it more and more as an investment program they will go into something with a higher interest.

Can you summarize what has happened to the oustanding savings bonds in the last 2 or 3 years so the committee will have that firmly in mind?

Mr. STALNECKER. Yes, Congressman. The amount of outstanding savings bonds peaked at $80.9 billion back in 1978 and they currently stand at $67.5 billion, so that over that 5-year period the amount of savings bonds outstanding has dropped by about $13 billion. Over the past 2 years——

Mr. CONABLE. Of that $67 billion, how many can you anticipate will go to maturity? Is there a ratio on that?

Mr. STALNECKER. I can check to see what the average life of the outstanding savings bonds are.

Mr. CONABLE. Of course, if they do not go to maturity they get an even worse deal because of the graduated rate on them.

Mr. STALNECKER. That is correct.

[Pause.]

A good proportion of the $67.5 billion outstanding represents holders that have already had their maturities extended.

Mr. CONABLE. In other words, they are locked into it and do not want to cash in their bonds because it will push them into a higher bracket. Is that it?

Mr. STALNECKER. That is part of it. Certainly the tax liability to be incurred would discourage that kind of cashing in. Many of the bonds are newly sold and during the first quarter of this year we had sales of about $800 million. Many of those bonds are redeemed early, before maturity, as you suggested.

Mr. CONABLE. Is there any administrative problem if we cut the rate loose as you suggest? Could that be done with respect to all outstanding bonds immediately?

Mr. STALNECKER. The plan we envision would cut loose the rate, as you say, for all outstanding bonds as well as new bonds after a 5-year holding period. The reason we would have the 5-year holding period as a prerequisite for the new market-related rate is that we are trying to encourage longer term savings rather than the short-term cashing-in type buyer.

We also feel that to make sure the program does not represent excessive competition with depository institutions which are still regulated in many of their short-term deposits, it is better to have a longer term vehicle for the savings bond program rather than a short-term one, so the existing holders as well as the new holders of savings bonds would be eligible after a 5-year period.

Mr. CONABLE. Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Duncan will inquire.

Mr. DUNCAN. Thank you, Mr. Chairman. Let me clarify one thing. You said after 5 years of holding. Do you mean after 5 years from the authorization of this legislation? What if they have already held bonds for 5 years?

Mr. STALNECKER. It would be 5 years after the authorization of the new program. In other words, a person who has already held his bonds for 5 years would have to hold an additional 5 years.

Mr. DUNCAN. What is the current bond rate?

Mr. STALNECKER. Nine percent for those holders of 8 years.

Mr. DUNCAN. In other words, if you bought them back in the 1940's and 1950's they would pay 8 percent now?

Mr. STALNECKER. They would pay 9 percent.

Mr. DUNCAN. What do you envision would be the current rate if this legislation is enacted?

Mr. STALNECKER. It would depend upon the future course of interest rates. The proposal, as we envision it, would give the holder 85 percent of the average market rate on 5-year Treasury notes for the holding period.

Mr. DUNCAN. What would that seem to be?

Mr. STALNECKER. A little over 11½ percent. If rates stay where they are for the next 5 years, the rate paid 5 years from now would be about 11½ percent.

Mr. DUNCAN. Are the earnings tax free?

Mr. STALNECKER. The interest accumulated would be deferred from taxes under the new program, just as they are under the existing program.

Mr. DUNCAN. Thank you. Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Pease will inquire.

Mr. PEASE. Thank you, Mr. Chairman. Would you expect to continue the present penalty for early redemption of savings bonds under this proposal?

Mr. STALNECKER. Yes. It would incorporate an ascending yield scale which would increase as the holding period increases. Currently the bond provides a return of 4 percent if it is held for 6 months and that gradually increases to 9 percent on an ascending scale.

The new program would incorporate the same kind of ascending return vis-a-vis the holding period, and the guaranteed rate would be dependent upon whatever the current market rate would be. So the holder who cashed in prior 5 years would not get 85 percent of the market but some predetermined rate.

Mr. PEASE. Currently how long does a person have to hold a bond to get 9 percent?

Mr. STALNECKER. Eight years.

Mr. PEASE. What if he cashes it in at 2 years? What kind of return does he get?

Mr. STALNECKER. The rate at 2 years is 6½ percent.

Mr. PEASE. Wouldn't it be attractive to people not to penalize them in that way for savings bonds? Wouldn't that be another way to increase the sales of savings bonds?

Mr. STALNECKER. It would be. But remember, the administrative costs of the savings bond program are an initial element and must be calculated when you consider the cost to the Government. For instance, if a bond is cashed in after 6 months, instead of 4 percent the actual cost to the Government is significantly higher because the fixed cost of the issue and sale of the savings bond has to be covered over that 6-month period.

One of the reasons we have the ascending scale is to take into account the higher effective costs to the Government of the savings bond cashed in before its maturity due to higher administrative expenses. So you have to draw a fine line between having a return high enough so the savings bond holder is willing to purchase the bond, but a rate not so high that if the bond is cashed in early the effective cost to the Government outweighs the benefits.

Mr. PEASE. I see. I am interested in how you arrived at the 85-percent figure. If a person were 58 years old and planning to retire at 65, would that person be better off buying savings bonds and having the tax deferred for 8 years rather than buying 6-month and 1-year Treasury bills and paying tax along with them?

Mr. STALNECKER. That would depend upon the tax bracket of the buyers. Certainly if the purchaser was in a very high tax bracket the after-tax return on the savings bond could be higher over that 8-year period.

The reason we selected 85 percent of the market is that we undertook some studies which indicated that the savings bond program in the past has run into major cash flow problems when the rate on savings bonds fell below 75 percent of the market rate. Therefore, we realized that the rate on the savings bond had to be at least 75 percent of the market to be viable.

One hundred percent of the market is too high for the reasons of tax deferral, and the early redemption privilege and also our administrative expenses. We knew the ballpark we were working in, therefore, was 75 to 100 percent. After looking at several relationships of different percentages and different marketable security maturities, it looked as if 85 percent of the 5-year rate was fair to the holder and, taking into account the extra costs of administration and tax deferrals, also represented a cost-effective rate for the Government.

I must admit there is a lot of subjectivity involved in this kind of a guesstimate and one of the reasons we would prefer not to have a specific formula incorporated into the legislation is we would like to have the ability in the future, after we test this current proposal, to adjust the rate in consideration of how the savings bond proposal actually works out in the marketplace.

The 85 percent, we feel, is fair and based on past history should result in some growth of the program without being too good a deal from the tax deferral standpoint.

Mr. PEASE. Thank you. I have just one general question. In the last page of your testimony you say we face large borrowing requirements over the foreseeable future. Is that any indication of a

lack of faith on the part of the Treasury in the viability of the economic recovery program?

Mr. STALNECKER. No. The borrowing requirements I refer to there are based upon the projected budget deficits incorporated in the last official budget numbers which, of course, do not indicate a balanced budget for several years.

The key point there is that in addition to the borrowing we have to do to finance the deficit, both on and off budget, we also have to refund our maturing securities. We have approximately $300 billion in securities maturing in the coming year. We would have to borrow from the marketplace to refinance even in the absence of borrowing requirements for new cash. So for the foreseeable future we will have to be in the market on a regular basis, and that is why we feel it is imperative to have access to all market sectors and appeal to all different types of buyers.

Mr. PEASE. That is very reassuring. I was fearful at first that the Treasury might not be completely confident of the success of the economic recovery program. I would not want that to happen.

Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Are there any further questions?

Mr. ANTHONY. Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Anthony will inquire.

Mr. ANTHONY. Thank you, Mr. Chairman. I would welcome Ms. Buchanan before the committee. The last time I had an opportunity to visit with her we had a white knuckle flight out of National Airport after the ill-fated Air Florida flight. I would like to congratulate you on trying to do two things—one, help the Federal Government do a little bit better job of debt management but at the time acknowledge the problem that I think is inherent in managing money at the present time. That is that our markets are biased toward large, sophisticated investors, and we are and have in the past been taking advantage of small savers.

I think it is high time the Federal Government brought some equity into the financial market so that the small savers who have literally bailed this country out with an inadequate return on their savings in the past are finally having their voice expressed in Congress.

I, for one, would like to thank you for making these proposals to help the small saver. But at the same time I would like to address a very sensitive and critical problem. That is, the debt management of the Federal Government.

You have in your testimony given the projected interest expense for fiscal year 1982 at $116 billion. I wonder if you have some internal documents that would indicate that your projected interest expense is for fiscal years 1983 and 1984, and if you could share those with me today.

Mr. STALNECKER. The estimated expense for 1983, based upon the most recent revision of the budget made public in April, is $134 billion.

Mr. ANTHONY. For 1984?

Mr. STALNECKER. We do not have a number available for fiscal year 1984.

Mr. ANTHONY. So the estimated interest expense for fiscal year 1983 is some $18 billion in excess of what you had projected to have

to pay to finance our extravagant ways. Is that based upon what some would call rosy or overly optimistic economic projections in the fiscal year 1983 budget and, if so, do you have any internal documents that would indicate what the high side would be? In other words, what is your outside number and what would you be prepared to pay in the marketplace for financing if those projections do not come forward?

Mr. STALNECKER. I would not want to typify the economic assumptions as either rosy or unrosy, but I can give you the actual interest rates assumed in making these forecasts and the current rates and you can make your own determination as to their accuracy.

Mr. ANTHONY. Fine, I would like that.

Mr. STALNECKER. The 3-month rate we assume for fiscal year 1982 is 11.6 percent and for fiscal year 1983 it is 11.1 percent. Those rates are currently about 12⅜ percent. For the intermediate notes—let us say the 3- to 6-year note rate—we are assuming for fiscal year 1982 13.2 percent and for fiscal year 1983 12.9 percent. That rate is currently about 13¾ percent. And at the longer term area, those maturities that are in excess of 6 years, for fiscal 1982 we are assuming 13.3 percent and for fiscal 1983, 13.1 percent, and those rates are currently about 13½ to 13⅝ percent.

So the assumptions do assume some reduction in interest rate levels from current market conditions. But markets are extremely volatile, as you know, and rates have risen and declined rapidly in very short periods of time.

Mr. ANTHONY. What I would like to know is from a manager's standpoint how difficult is it going to be for the Treasury to finance the debt if it continues to grow larger? By your projection you are going to have a $134 billion debt to manage, possibly, in fiscal year 1983.

If you do not get these management initiatives and knowing that your short-term debt is increasing each year rather than being extended, just from a management standpoint how difficult is it?

Mr. STALNECKER. The buildup in the short-term maturity makes strategy for managing the public debt extremely difficult. For one thing, it reduces one's flexibility. You are really the prey of the market and if we have to finance a lot of securities in market environments with interest rates very high, it increases the cost of our debt and adds to market disruptions which might be occurring at the time.

As a general rule, I think the question of financing any given level of deficit depends upon several things in addition to the actual size of the deficit being financed. Markets are always looking out into the future to look at prospective developments, and probably more important than the current financing needs of the Government are what the market anticipates the needs to be in the future. That is why the current budget negotiations are being watched very carefully by the marketplace. Federal Reserve policy over the long run is also watched closely by the marketplace because the thing that markets are trying to gage is what the financing requirements will be in the future, what inflation and monetary policy will be in the future, and as long as the markets are assured that future deficits and future budgets are going to be

under control and that future monetary policy will be responsible, then I think that would increase the ability to finance the debt.

To the extent the market sees the budget process as not being under control, then it will be difficult to finance a given level of debt. So it is really a question you cannot answer unless you know what the outlook is for the future when you are trying to finance the deficit.

Mr. ANTHONY. Thank you very much.

Chairman ROSTENKOWSKI. If there are no further questions, we thank you, Mr. Stalnecker.

Mr. Stalnecker, I have one final, unofficial question. What is your current estimate of when action on the debt ceiling will be necessary?

Mr. STALNECKER. Our current estimates, which change from time to time based on our cash flow and our borrowing in the marketplace, is that we will need some kind of action by the end of May.

Chairman ROSTENKOWSKI. Thank you very much.

We want to welcome to the committee Congressman Roth. It is always a pleasure to have you testify.

STATEMENT OF HON. TOBY ROTH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. ROTH. Thank you, Mr. Chairman, Mr. Conable, distinguished Members of the Ways and Means Committee. I appreciate this opportunity to present this testimony in conjunction with today's hearing on linking the interest rate on savings bonds to market rates of interest.

Mr. Chairman, because of the time limitations, I ask that the committee accept my testimony that I have submitted and allow me to summarize my opinions here.

Chairman ROSTENKOWSKI. Your statement will be included in the record in full.

Mr. ROTH. Thank you, Mr. Chairman.

Last fall I introduced legislation to link interest rates on savings bonds to market rates of interest. In January of this year I held hearings in Green Bay, Wis., to give people who have a vital interest in the interest rates and savings bonds a chance to speak up. We had excellent testimony from Wisconsinites in Green Bay.

We had input from representatives of the military, especially our National Guard, representatives from the paper mills, factories, and especially the small savers. And the testimony was unanimous that if we are going to keep savings bonds as a viable form of investment for small savers we must adjust the interest rates. High interest rates seem as unconscionable as chewing gum and as long as this is the case I feel we must adjust our savings bond program accordingly.

From a study and investigation that I have undertaken, it is as clear as a bell to me that if we want to prevent the avalanche of redemptions now taking place in savings bonds we must analyze how best to stem this tide, and it is my contention that the only way we can do it is by reviewing the interest schedule so we can motivate our small savers to keep investing in savings bonds.

Money today, especially for small savers, is, as we all know, tighter than bark on a tree, and the small saver has also become much more sophisticated. Now I have had encouragement from the Office of Management and Budget and the Director of the savings bond program, Miss Angela Buchanan, who was here this morning. I have also had encouragement from the head of the States savings bonds directors.

We are now conducting annual drives, as you know, for the payroll savings plan in large and small companies in each of the 50 States and this is where we get most of our impetus for the investments in the savings bond program. My office has letters from throughout the country. People everywhere have written as they have learned of this initiative and have encouraged us in our work here.

In February Senator Roth introduced companion legislation in the Senate and I am told that there is a scheduled hearing, a joint meeting of the Subcommittees on Taxation and Savings next week. So certainly I feel it is the appropriate time to move in a full review of the legislation and action by this Committee and by the House of Representatives.

As I mentioned, in our field hearings we had a great deal of testimony. Mr. Chairman and members of the committee, I would just like to quote a couple of the opinions given there. One quote is from Brig. Gen. Edward Wulgaert, U.S. Army National Guard, who has been in the service for 29 years. Here is what he had to say, and I quote:

> I believe the latest Treasury report shows something like one-third of the amount of money that is put into bonds by the Federal work force today is put in by service members. Overall, the payroll savings plan has helped many American soldiers to put something aside for later in life and has been the most convenient and tailor-made program for the average GI.
>
> Support for these incentives can enhance payroll savings plans in the Armed Forces, and in this soldier's opinion it would be very rewarding for the people that we need the most, and that is the people in our lower grades.

We heard from the president of the Oscar Mayer Co., Jerry Hiegel. The Oscar Mayer Co. for years and years has been involved in the savings bond program. He says this:

> Oscar Mayer & Co. has supported the savings bond payroll deduction plan for employees since World War II. In terms of percentage participation by our employees, we are consistently ranked among the top industrial firms in the country. Oscar Mayer people have contributed many hours of their time to leadership roles on behalf of savings bonds. Oscar Mayer, Jr., the retired chairman of our company, proudly served two terms as national chairman of the savings bond drives, and I am proud to say I currently serve as chairman of the Wisconsin savings bonds volunteer program. I believe in savings bonds. I have been buying them for many years.

Another constituent, Glen Macaux, an insurance professional, said this:

> Maybe we should, in view of our large deficits in Government, consider giving a tax break to people who can save a small amount of money in bonds which would discourage them from going elsewhere. For the small saver, I think payroll deductions always have been a very attractive and a very easy way to save money. I think this idea should be encouraged and retained. If you can embellish that any more if the Government can advance, accelerate, and publicize this program, I think it would be beneficial to everyone because the majority of the people in this country are small savers, not large savers.

And Thomas Murphy, from Fort Howard Paper Co., just named to the Fortune 500 list said this:

Refinement of the program will make savings bonds more competitive with other Government monetary instruments. An updated program would be particularly beneficial to small and beginning investors who find other U.S. Treasury investments out of their reach. We are happy to be a part of this program.

Again, Mr. Chairman and members, I appreciate the opportunity to appear before your committee because I have had a great interest in this program. I know from the letters I get throughout the country from small savers that there is tremendous incentive throughout the country to be a part of the savings bond program because it is a patriotic thing to do. People are becoming more sophisticated. They will not invest their money at 9 percent when they can invest it at 13 and 14 percent.

So I hope we address this issue, Mr. Chairman and members of the committee.

[The prepared statement follows:]

STATEMENT OF HON. TOBY ROTH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. Chairman, Mr. Conable, Distinguished Members of the Ways and Means Committee, I appreciate this opportunity to present testimony in conjunction with today's hearing on linking the interest rate on savings bonds to market rates of interest.

Last Fall, I introduced legislation to do just that. Following field hearings in Green Bay Wisconsin, in January 1982, I refined the provisions of the original bill and introduced H.R. 5480 which has been referred to this Committee. In the interests of the time constraints of all of us, I'd like to submit written testimony and summarize my views at this Hearing.

In the interests of fairness to the thousands of small-savers who have "taken stock in America" since the inception of the Second Liberty Bond Program in 1941, I believe it is imperative that the rate of interest paid on the Bonds be at a level competitive with comparable investments. Specifically, this could be fixed to not exceed 85 percent of the 52-week Treasury bill rate determined at the auction the week preceding the issuance of the Savings Bond Certificate. This is only slightly different from the proposal set forth by the Treasury Savings Bond Division.

I've received encouragement for the concept of this legislation from the Director of the Office of Management and Budget; the Director of the Savings Bond Program, Ms. Angela Buchanan who appears before you today; and the head of the State Savings Bonds Directors, who are now conducting annual drives on behalf of the Payroll Savings Plan in large and small companies in each of our 50 states. My office has received letters of support for this bill from people all over the country who have learned of this initiative.

In February, Senator Roth introduced companion legislation in the Senate which is scheduled to receive a hearing at a joint meeting of the Subcommittees on Taxation and Savings next week.

Certainly, it is the appropriate time to move forward in a full review of the legislation and action by this Committee and by the House of Representatives. I'm pleased to be here today to urge your support both for the bill and for prompt scheduling of hearings on it. This will allow all interested parties to make their views known to the distinguished members of the Ways and Means Committee.

I'd like to share some short excerpts of testimony from people in Wisconsin who share my concern for the current trend of early redemptions by U.S. Savings Bondholders.

As a significant number of savings bonds have traditionally and are currently purchased by our men and women in military uniforms, I'd like to share some comments from Brigadier General Edward Wulgaert, US Army National Guard who has 29 years of military experience:

"I believe the latest Treasury report shows something like one-third of the amount of money that's put into bonds today is put in by service members. . . . Overall the payroll savings plan has helped many American soldiers to put something aside for later in life and has been the most convenient and tailor-made pro-

gram for the average GI. . . . Support for these incentives can enhance payroll savings plans in the Armed Forces, and in this soldier's opinion, it would be very rewarding for the people that we need the most, and that's the people in the lower grades."

The small savers who participate in the Savings Bond program through payroll deductions are other major contributors to the program. The following remarks are by the President of Oscar Mayer and Company, Jerry Hiegel:

"Oscar Mayer and Co. has supported the Savings Bond payroll deduction plan for employees since World War II. In terms of percentage participation by our employees, we have consistently ranked among the top industrial firms in the United States. . . . Oscar Mayer people have contributed many hours of their time to leadership roles on behalf of Savings Bonds. Oscar G. Mayer, Jr., the retired chairman of our company, proudly served two terms as national chairman of the Savings Bonds drives. . . . I'm proud to say that I currently serve as chairman of the Wisconsin Savings Bonds volunteer program. . . . I believe in Savings Bonds, and I've been buying them for many years. And it's not that other investments aren't more attractive, because you and I know there are better places for a person in my tax bracket to put his money. I've bought bonds because they're easy to buy through payroll deductions. I've bought bonds because they provide a nice emergency fund for my wife and our eight children to use in the event something happened to me. And, this may sound corny to some people today, but I have also bought Bonds because it's a patriotic thing to do. Savings Bonds help this great country of ours by reducing the amount the federal government has to borrow elsewhere to fund its programs. That helps to keep our federal deficit down and acts as a brake against inflation. . . . Something must be done—and soon—to restore the Savings Bond program's health and vitality."

Another constituent, Glen Macaux, an insurance professional, commented on the advantages Savings Bonds could have for the small investor:

"Maybe we should, in view of our large deficits in government, consider giving a tax break to people who can save a small amount of money in bonds which would discourage them from going elsewhere. . . . For the small saver I think payroll deductions always have been a very attractive and a very easy way to save money, and I think this idea should be encouraged and retained, and if you can embellish that any more than that, if the government can advance, accelerate, publicize this program, I think it would be beneficial to everyone because the majority of the people in this country are small savers, not large savers."

Mr. Thomas Murphy, of Fort Howard Paper Company, newly named to the Fortune 500 list, ranking 6th in return of sales, provided his organization's support for refinement of the Savings Bond program:

"Refinement of the program will make Savings Bonds more competitive with other government monetary instruments. . . . An updated program would be particularly beneficial to small and beginning investors who find other U.S. Treasury investments out of their reach."

Again, I appreciate this opportunity to share my concerns for the small saver and for the future of the Savings Bond Program. I believe it should and could continue to be an investment vehicle for millions of Americans in the future as it has been in the past. Current economic conditions indicate clearly a need for change in the interest yield of the U.S. Savings Bond. It is my conviction that action by this expert and experienced Committee will be taken with regard to my bill as well as the proposals made by representatives of the Administration that share this witness table with me today. Thank you for your time and your consideration. I look forward to testifying more fully before you about H.R. 5480 in the near future.

[H.R. 5480, 97th Cong., 2d sess.]

A BILL To amend the Second Liberty Bond Act to increase the investment yield on United States savings bonds to a level competitive with fifty-two-week treasury bills

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That paragraph (3) of section 22(b) of the Second Liberty Bond Act (31 U.S.C. 757(c)) is amended to read as follows:

"(3) Notwithstanding paragraph (1), the Secretary of the Treasury shall fix the investment yield on any United States savings bond at a yield which makes such bond competitive with comparable investments: *Provided, however,* That in no event shall the investment yield on such bonds exceed 85 per centum of the average investment yield for the most recent auction (before the week in which the certificate is issued) of United States Treasury bills with maturities of fifty-two weeks.".

95-454 O—82——2

SEC. 2. The amendment made by section 1 hereof shall apply with respect to interest accrual periods beginning after the date of enactment of this Act.

U.S. HOUSE OF REPRESENTATIVES,
Washington, D.C., February 9, 1982.

DEAR COLLEAGUE: On February 8, I introduced H.R. 5480 to increase interest rates on U.S. Savings Bonds to a rate equal to 85 percent of the yield on 52-week Treasury Bills. This is similar to the formula for the All Savers Certificates. H.R. 5480 is a refinement of my bill H.R. 4853. The modifications were identified during field hearings in my congressional district in mid-January.

Cosponsors of the original bill include Congressmen Barnes (D-MD), Dwyer (D-NJ), Fish (R-NY), Foglietta (D-PA) and Whitehurst (R-VA). Support for the concept of this legislation comes from the Office of Management and Budget, the Secretary of Treasury and the Director of the Savings Bonds Program. Senator William Roth introduced a companion bill in the Senate and will hold early hearings in his subcommittee. I look forward to hearings in the appropriate House committee shortly.

Without changes in the level of interest payable on these bonds, their popularity will continue to plummet. Legislation passed in 1980 purported to grant Treasury the authority necessary to keep Savings Bonds competitive in the market place. However, the economy has proven too volatile for the semiannual one-percent adjustments provided in current law.

The Government's ability to finance the public debt at lower interest rates has been diminishing in recent T-Bill auctions. And, trends in Saving Bond holdings reveal increasing unrest among holders about the benefits of their saving through these bonds. If 1981 figures continue unchecked in 1982, tens of billions of dollars in Savings Bond holdings will have to be "rolled over" into higher-yielding securities. This can only further fuel the high-flying deficits which have been the weakness in our economic recovery.

We need to act quickly to make it profitable for millions of small savers and thousands of military personnel to continue to "take stock in America." If you wish further information or desire to cosponsor this legislation, please contact Gregory M. Hensas, at X55665.

Sincerely,

TOBY ROTH.

Chairman ROSTENKOWSKI. Thank you for your testimony and all the other fine work that you have done. It has been a benefit to the committee.

Mr. CONABLE. Can I just say a word? Sometimes in the great issues facing us we forget to do the obvious. I think we need to have people point out the obvious to us, and the obvious is the equity of this proposal. It is something that you have noticed and pushed for and I think it has helped a good deal in moving it along. Thank you, Toby.

Chairman ROSTENKOWSKI. Mr. Vander Jagt will inquire.

Mr. VANDER JAGT. Thank you. I just want to thank my friend and colleague for a very fine testimony on a subject on which he has done a considerable amount of outstanding work. Thank you.

Mr. ROTH. Thank you very much.

Chairman ROSTENKOWSKI. Thank you very much.

The Chair would like to welcome Prof. Benjamin Friedman to the committee. It is a pleasure to have you here with us. We are grateful to you for sharing your time with us. If you will identify yourself for the record, you may proceed with your testimony.

STATEMENT OF BENJAMIN M. FRIEDMAN, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. FRIEDMAN. Thank you very much, Mr. Chairman. I am very grateful for the opportunity to be here today to share my views with the committee. I have submitted a written statement. Rather

than take the committee's time to read all the way through it, I think that I should summarize the main points in a few minutes.

Chairman ROSTENKOWSKI. Professor, your entire statement will be included in the record.

Mr. FRIEDMAN. Thank you, sir. Let me begin by simply stating the conclusions I would urge this committee to reach and the advice I hope it will give to the Treasury. Then I will say a little about why I think those conclusions are justified.

In brief, I do hope that the committee and the full Congress will approve the Treasury's request for authorization of increased ability to issue long-term bonds at market rates of interest. At the same time, however, I also hope that the Treasury will use this additional authority very sparingly. I hope that this committee, as well as the full Congress, in the process of granting the Treasury's request, will make clear that it also desires the Treasury to issue very few long-term bonds in comparison with the pattern of debt management that the Treasury has pursued in recent years.

Let me now explain very briefly why I think this subject is an important one, and why I think some change in debt management policy from what the Treasury has been doing in recent years would be helpful.

One of the most central objectives of U.S. economic policy today, which I think is widely shared both in the Congress and in the administration as well as outside of Government, is to increase our rate of capital formation in the private sector. We need more capital formation primarily in order to encourage our economy's rate of productivity growth, which has been painfully inadequate for several years.

At the same time, this committee has already heard a great deal of concern from a variety of sources, including from within the Congress, that the extremely large projected Federal deficits for the next several years will threaten the private sector's ability to undertake this much-needed capital formation. I believe that those concerns are valid and that the problem is serious.

What faces us today is a conflict between the Federal Government's borrowing requirements and the borrowing requirements of the private sector in connection with its doing more investment in productive plant and equipment. I believe that the most important objective for debt management policy ought to be to see that that conflict is minimized. In other words, the object of debt management policy ought to be to finance the Federal deficit in such a way as to minimize the negative influence on the private sector's ability to finance its own capital formation.

How should debt management policy go about that? Businesses, for very valid reasons, usually prefer to finance investments in long-lived facilities like new plant and new equipment by issuing long-term liabilities. That is typically sensible business policy.

The problem then is that, after the recent few years of experience with the rapid inflation, rising interest rates, and volatile bond prices, even those groups of lenders who have traditionally been most committed to the long-term bond market are now shying away. As a result, the supply of long-term lending available in the U.S. markets is growing smaller every year. But as the supply grows smaller, the problem facing the private sector, which is

trying to finance capital formation, is worsened each year as the U.S. Treasury absorbs a larger and larger part of that shrinking supply of long-term lending.

Indeed, last year the supply of long-term bonds issued by the Treasury was more than one-half the entire long-term financing in the corporate bond market by all U.S. corporations engaged in nonfinancial lines of business. It is simply no longer the case that the amount of long-term bond issues by the Treasury small in comparison with the size of the overall long-term market. It is large, and in recent years it is growing much larger.

It is also important to appreciate that U.S. debt management policy has not always been conducted in this way. For the first three decades after World War II, the Treasury primarily issued short-term securities and, therefore, did minimize the extent to which its own borrowing conflicted with that of the private sector financing capital formation. As a result, as the Treasury representatives have already explained, the average maturity of the outstanding U.S. Government debt fell throughout this period.

That debt management policy, which had persisted for the first 30 years after World War II, abruptly changed in 1975, however. Since then the Treasury has pursued exactly the opposite policy, emphasizing long-term debt in its own securities issues and therefore raising the average maturity of the outstanding Federal debt just as rapidly as the average maturity had fallen over the previous 30 years. As a result, the average maturity is now back up to 4 years, which is almost the level it had reached in 1959.

There may well have been some advantages in raising the average maturity of the Federal debt from the low level of 1975, but I believe that those advantages have already been reaped. From now on, the primary objective of debt management policy should be to stay out of the way of private sector financing of capital formation. At the very least, what that dictum means is a policy of avoiding further increases in the average maturity of the debt. I see no reason to drive the average maturity back down. But, at the same time, I regard the policy we have been pursuing since 1975, of continually raising the average maturity of the debt by continually emphasizing more and more long-term issues, as counterproductive.

It would be ironic if, at this time when the administration's economic proposals have as such a central element the stimulation of private capital formation for purposes of improving our productivity and international competitiveness the Treasury should be pursuing a policy that maximizes instead of minimizes the damage Treasury financing does to the long-term capital markets.

In sum, I do hope that the committee and the full Congress will grant the Treasury's request, simply because I do not see a need for the average maturity of the debt to go back down as it did in previous years. I also think that it is unhelpful for technical reasons to tie the Treasury's hands.

At the same time, I hope that this committee and the full Congress will recognize that debt management policy is important, that it has an important bearing on the ability of the administration's and the Congress economic objectives to be achieved, and that we can better achieve those objectives by having a debt man-

agement policy which issues fewer rather than more long-term bonds.

Thank you very much for the opportunity to present my views, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF BENJAMIN M. FRIEDMAN, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. Chairman, I am honored to have the opportunity to present my views to this Committee as it considers the Treasury's request for removal of the limitation on issues of long-term U.S. Government bonds at market rates of interest. Although public policy discussions usually focus more on the size of the federal government's budget deficit than on the mix of securities issued to finance that deficit—and rightly so—one form of government borrowing is not the same as another, and the Treasury's choice among them is also important. Federal debt management policy affects the government's liability for future debt service and also influences the technical functioning of the nation's securities markets. More importantly, federal debt management policy affects interest rate relationships, via interest rates affects patterns of private-sector financing, and hence ultimately affects both the level and the composition of nonfinancial economic activity.

I hope that this Committee will recommend, and that the Congress will approve, the authorization which the Treasury has requested to issue new long-term bonds. But I also hope that both this Committee and the full Congress will urge the Treasury to use this authorization sparingly. I believe that reducing the recent heavy reliance on long-term bonds to finance the federal government's budget deficit would better enable the economy's private sector to finance capital formation for growth and productivity, and to do so without sacrificing financial soundness.

THE ROLE OF DEBT MANAGEMENT POLICY

Since February, when the Administration submitted its budget proposals for fiscal year 1983, this Committee has heard much about the potential consequences of the large budget deficits projected for coming years. The central thrust of those concerns has been that the securities issued by the Treasury to finance these deficits would "crowd out" of the market securities that other borrowers would otherwise issue to finance private capital formation. Some private borrowers, of course, would be successful in raising market funds in any case. As a result of the Treasury's borrowing, however, others would restructure their financings to rely on securities competing less directly with U.S. Government issues, and still others would have to forgo the physical investments they had originally planned. In the end, the record-size federal budget deficits would "crowd out" much of the private capital formation needed to restore the nation's flagging productivity growth and international competitiveness. It would also substantially vitiate any hope of fostering a more stable long-run economic equilibrium by stimulating the supply of goods and services more than the demand.

I believe that these concerns are well founded, and that they are serious. They reflect a broad agreement on the need for increased capital formation in order to spur productivity growth, together with the spreading recognition that U.S. capital formation, measured correctly, is not gaining but skrinking. The nation's total new investment in plant and equipment, net of depreciation and obsolescence, actually fell from a 4 percent share of gross national product on average during 1966–70 to only 2.8 percent during 1976–80, and only 2.5 percent last year. Even the Administration's optimistic budget projections—not to mention the range of Congressional and private estimates—raise the prospect that the Federal Government's deficit will exceed the economy's entire net investment in plant and equipment each year for the foreseeable future. There is only limited evidence of such "crowding out" to date, because the economy remains in recession. Once it recovers to a fuller utilization of resources, however, the conflict between Federal Government deficits and private capital formation will probably be severe.

The chief objective of federal debt management policy should be to limit that conflict as much as is possible. To be sure, no scheme of debt management can eliminate the financial pressure of U.S. Government securities issues altogether when the federal deficit is large. But the Treasury can and should choose what securities to issue so as to minimize the interference with private investment in productive plant and equipment. In light of the widespread agreement on the need for such investment, together with the prospect of record-size deficits even after the economy

returns to full employment, this role of debt management policy is perhaps of even greater importance now than at any time in recent history.

The basic reasons why federal debt management can affect such seemingly distant aspects of economic activity as business investment is that neither borrowers nor lenders are indifferent to the maturity of the debt securities that they either issue or hold. In order to reduce risks associated with the cost and availabililty of future refinancing, businesses funding investments in long-lived physical facilities typically seek to finance those investments by issuing long-term debt. That perference would not matter if lenders were as willing to advance funds at long term as at short term, but in fact most lenders appear to prefer to hold short-term securities. Indeed, after their recent experience with rapid inflation, high interest rates and volatile bond prices, many traditional participants in the long-term markets are now reluctant to commit funds to extended maturities, turning instead to short-term instruments and other securities with more stable values. As a result, businesses seeking to issue bonds to finance fixed capital formation have found long-term financing more costly and, in many cases, less available.

When the Treasury issues large volumes of long-term bonds, it further raises the cost, and further reduces the availability, of long-term financing for business and other private-sector borrowers. Discouraged by an unreceptive bond market, a business seeking to finance a new plant, or new equipment to modernize an old one, can respond in either of two ways. One is simply to cancel or curtail its planned investment. The other is to go ahead with its investment on the basis of short-term financing, hoping to fund out its liabilities in the future but for the present accepting the deterioration in its financial structure. The experience of the U.S. economy during recent years has exhibited both of these patterns. Not only is fixed investment down, but business has increasingly financed what investment it has undertaken at short term, so that many corporations' balance sheets have weakened significantly.

If the Treasury instead issued short-term securities, it would free the limited supply of long-term lending to go to borrowers in the private sector. In some cases the result would be additional private capital formation. In others it would be a more secure financial structure. Either way, reliance on short-term financing in federal debt management would promote a more productive and financially sound economy.

RECENT AND PROSPECTIVE DEVELOPMENTS IN FEDERAL DEBT MANAGEMENT POLICY

During most of the post World War II period, the Treasury managed the federal debt in a manner consistent with leaving as much as possible of the market's supply of long-term lending for private borrowers. When the war ended, the outstanding marketable interest-bearing debt held by private investors consisted mostly of long-term securities. Over the next three decades, the Treasury typically refinanced maturing issues and financed new budget deficits by relying on shorter-term securities, so that the average maturity fell from almost ten years at yearend 1945 to just under two and a half years by yearend 1975 (see Table 1). The percentage of the outstanding debt maturing within one year more than doubled over these three decades, while the percentage maturing in one to five years also increased, and the percentage maturing in over five years declined dramatically.

TABLE 1.—MATURITY STRUCTURE OF MARKETABLE INTEREST-BEARING U.S. GOVERNMENT DEBT PRIVATELY HELD

Yearend	Total (billions)	Distribution (percent)					Mean maturity (month)
		Within 1 yr	1 to 5 yrs	5 to 10 yrs	10 to 20 yrs	20 yrs and over	
1945	$167.5	28.1	20.5	19.1	19.2	13.1	116
1950	126.3	33.2	25.3	12.7	28.9	0	100
1955	134.2	34.0	29.8	25.7	7.5	3.0	71
1960	153.5	38.2	37.5	10.4	7.5	6.4	58
1965	160.4	41.9	27.0	18.8	3.9	8.4	63
1970	168.5	49.9	33.9	7.5	3.9	4.8	41
1975	255.9	58.7	29.2	6.5	3.3	2.3	29
1980	492.3	48.7	32.4	8.4	5.5	5.0	45
1981	580.7	47.4	32.4	8.8	5.9	5.6	48

Note: Callable securities classified by date of first call for 1945–55, by final maturity for 1960–80.

Source: U.S. Department of the Treasury (Treasury Bulletin, Office of the Secretary of the Treasury, Office of Government Financing).

Since 1975, however, the Treasury has pursued exactly the opposite policy, placing sufficient reliance on long-term securities to raise the overall average maturity outstanding back to 4 years by the end of last year. This new debt management policy has involved a regular cycle of short- and medium-term note issues, together with a series of new 30-year bonds. The outstanding U.S. Government debt maturing in more than ten years grew from only $14.4 billion at yearend 1975 to $66.1 billion at yearend 1981. Last year alone, for example, the net increase in outstanding Treasury debt maturing in more than 10 years—that is, gross new issues with more than ten years initial maturity, less purchases by U.S. Government trust accounts, less the amount of outstanding issues moving from over to under 10 years maturity by the passage of time—was $14.2 billion. In comparison, the entire net volume of corporate bonds issued last year by U.S. firms in nonfinancial lines of business was only $25.1 billion, and much of that total consisted of medium-term issues.

With its post-1975 debt management policy, therefore, the Treasury is now lengthening the outstanding federal government debt just as rapidly as the policy of the previous three decades shortened it. In doing so, it has been pre-empting for the government an historically unprecedented (at least in peace time) share of the economy's long-term borrowing and lending.

The post-1975 policy has by no means been entirely counterproductive. Indeed, at least so far, it may not have been counterproductive at all. Treasury representatives have argued that a longer average maturity makes it easier to plan the orderly refinancing of the outstanding debt. More importantly, the development once again of a large and highly active trading market for long-term U.S. Government securities, which the Treasury took steps to promote in the early days of its new policy, may have stimulated the market for long-term corporate securities and hence made them also more liquid than in the past. If so, not only the increased size of the Treasury's outstanding long-term debt but also the regular flow of new issues have contributed to this process. For this reason it is useful to keep the long-term U.S. Government securities market from becoming inactive, and therefore I support the Treasury's request for removal of the prohibition on further long-term issues at market rates of interest.

Even if its benefits have outweighed its costs thus far, however, the federal debt management policy pursued since 1975 has achieved its aims by now, and there would be little advantage in continuing to lengthen the debt further. The average maturity has already increased to four years, a level last reached in 1969 (and nearly as long as the average maturity at yearend 1959), so that the Treasury has now eased its planning problems. The active trading market is now in place. It is difficult to see what further technical gains would follow from a continued average lengthening from now on. By contrast, the economic impact in terms of reduced capital formation and weaker corporate balance sheets would only grow larger.

It would be especially unfortunate—indeed, ironically so—to continue further with the 1975–81 policy of lengthening the outstanding federal debt at this time. A central element in the economic policy advanced by the Administration, and in this case supported by the Congress, is the encouragement of increased private-sector investment in productive plant and equipment. Now the prospect of record-size federal budget deficits, even at full employment, threatens the economy's ability to undertake such investments. Financing these deficits in such a way as to lessen their negative impact on private capital formation should be the chief objective of federal debt management policy for at least the next few years.

ARE THE EFFECTS LARGE ENOUGH TO MATTER?

Research that I and others have recently done at the National Bureau of Economic Research indicates that the effects of federal debt management policy—on capital formation, on patterns of corporate financing, and even on the overall level of nonfinancial economic activity—are no more hypothetical nicety.[1] Instead, the evidence suggests that debt management actions of a magnitude comparable to the recent changes in the Treasury's debt management policy have sizeable effects both in the financial markets and more broadly. In particular, the evidence suggests that a federal debt management policy emphasizing short- instead of long-term debt issues

[1] The results described below are from Benjamin M. Friedman, "Debt Mangement Policy, Interest Rates, and Economic Activity," National Bureau of Economic Research, Working Paper No. 830 (December, 1981). See also V. Vance Roley, "The Effect of Federal Debt Management on Corporate Bond and Equity Yields," National Bureau of Economic Research, Working Paper No. 586 (December, 1980).

would lower yields on both government and corporate long-term bonds and on corporate equities, would raise yields on most short-term securities, and would stimulate output and spending. The stimulus to spending would be disproportionately concentrated in fixed investment, so that such a policy would not only increase the economy's output but shift its composition toward additional capital formation. Moreover, the change in the pattern of corporate financing from short- to long-term borrowing, in response to the change in relative interest rates, would be larger than the induced increase in investment spending. Hence such a policy would also lead to an improvement in corporate balance sheets.

A specific example may help to illustrate these widespread effects throughout the economy. One example of a debt management policy change that I considered in my recent research was increased reliance on short-term debt, and correspondingly reduced reliance on long-term debt, in an amount equal to $1 billion per year. Because my analysis focused on the mid 1970's, when the outstanding amount of U.S. Government securities (especially long-term securities) was much smaller, the $1 billion per year change then would correspond to roughly a $5 billion per year change today.

The analysis indicated that the immediate effect of this change in debt management policy would have been to raise short-term interest rates by about ⅛ percent (in comparison to the 5–6 percent level then prevailing) and to decrease long-term interest rates by about ¼ percent (in comparison to a level of 7–9 percent). In addition, the dividend yield on equities would have declined by enough to raise the average level of common stock prices by nearly 2 percent.

The analysis further indicated that these changes in interest rate relationships would have raised the average level of the economy's real output by almost ½ percent, or $5 billion in what was then a $1 trillion economy. Fixed investment, however, which comprised only about one-eighth of total spending (before netting out depreciated), would have accounted for nearly one-half of this $5 billion increase. Hence the results strongly supported the idea that a shift in federal debt management toward issuing shorter-term securities would disproportionately stimulate capital formation. Finally, the analysis showed that under this policy the volume of long-term corporate bond issues would have risen by even more than the increase in the corporate sector's fixed investment activity, so that corporations' reliance on short-term debt would have abated slightly.

This example, even buttressed by many more in my own and others' research, is far from conclusive. Drawing inferences about the likely effects of economic policy actions is difficult under the best of circumstances. The usual problems are even more severe in analyzing debt management policy, in that so little is known about the portfolio behavior of the relevant groups of bond market participants, as well as about investment behavior more generally. Substantial caution is appropriate in relying on this or any other piece of evidence on these questions.

Although it can be only suggestive, therefore, the evidence provided by this analysis is certainly consistent with the effects of federal debt management policy that are likely on logical grounds. Moreover, the evidence does suggest that these logically plausible effects are large enough to constitute an important concern for the design of policy.

CONCLUSIONS

In sum, I believe that federal debt management policy has an important role to play in furthering the overall objectives of economic policy. An appropriate debt management policy can help to facilitate private capital formation and sound patterns of corporate financing. Especially at a time when the economy needs productive fixed investment and when the federal government budget deficit will probably be unprecendently large, the role of debt management policy is to limit, as much as is possible, the negative effects on private capital formation and private balance sheets associated with financing that deficit.

I support the Treasury's request for removal of the limitation on issuing long-term U.S. Government bonds at market rates of interest. Some steady flow of new long-term U.S. Government issues may be helpful for maintaining an active trading market for long-term debt securities generally. In addition, placing such statutory restrictions on the Treasury's financing options may hinder its ability to respond appropriately to changing technical developments.

At the same time, however, I urge the Treasury to rely on long-term financing only sparingly. And I hope that this Committee and the full Congress, in granting the Treasury's request, will also urge at least a partial reversal of the policy of lengthening the outstanding debt which the Treasury has pursued since 1975. Great-

er Treasury reliance on short-term financing, which would at least keep the outstanding debt's average maturity from rising further, would better meet the needs of the 1980s.

Mr. Chairman, thank you again for the opportunity to present my views to the Committee.

Chairman ROSTENKOWSKI. Thank you, Professor Friedman. Mr. Conable will inquire.

Mr. CONABLE. I would just like to say I think that is a very interesting statement. It is something I do not believe we have considered a great deal. We have a tendency to think that better debt management means constantly longer maturities, and the thought that we are in competition with the private sector in a greater degree there than otherwise is a thought the Treasury should consider.

I do believe that flexibility is an appropriate posture even though the policy may be one of avoiding competition. I note that your conclusion is that the authority should be granted the Treasury in any event. But I think your warning is an important one. Thank you, sir.

Chairman ROSTENKOWSKI. Mr. Pease will inquire.

Mr. PEASE. Mr. Chairman, just one question. Sir, you seem very concerned that the Treasury not crowd out the private sector in terms of long-term borrowing. Even if the ratio stays as it is now, won't that effect occur as the deficit grows from year to year and the Treasury has to go in and borrow $100 billion or $150 billion additional beyond what it has borrowed before? Will not that factor really wash over the others regardless of what the length of the debt it, the average length of the debt.

The fact that we are going in for so much borrowing, I would think, would have much more impact on the private sector than the length of borrowing by the Treasury for whatever obligations they have. Am I correct in that?

Mr. FRIEDMAN. Yes, sir. I agree with you entirely. There is no way—at least no way I know of—that a cleverly designed debt management policy can ever eliminate entirely, or even eliminate largely the conflict between Federal borrowing and private sector capital formation when the deficits are as large as the ones we apparently face over the coming years.

I hope I did not give the impression that by clever debt management policy we can get this serious problem to go away. Even though debt management policy cannot make this problem go away, however, it can at least help somewhat. I see the debt management policy that we have been pursuing in recent years as not helping at all but as being counterproductive.

If we could at least move from a counterproductive debt management policy to a helpful one, we certainly would not get rid of the entire problem, but we could alleviate it somewhat.

Mr. PEASE. Thank you.

Chairman ROSTENKOWSKI. If there are no further questions, we thank you, Professor Friedman.

Mr. ANTHONY. Just one, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Anthony will inquire.

Mr. ANTHONY. I would like one followup question in response to your colloquy with Mr. Pease. You have stated it is counterproduc-

tive, but you have not particulated or specified what the harmful effects are to U.S. debt management extending into long-term rather than short-term, and I wondered if you would educate me as to what you perceive to be the harmful effect of our present debt management policy.

Mr. FRIEDMAN. Yes, sir. Let me be more explicit. When I say that it is harmful, I mean in the particular context that it damages the ability of the private sector to undertake investment in plant and equipment. A business that is trying to finance, for example, a new plant or the modernization of an existing plant is typically reluctant to finance that long-lived investment on the basis of a short-term bank loan or commercial paper or some other such short-term liability. The facility that is being put in place will be there for many years, and yet the financing would have to be renewed very quickly, perhaps in the face of market conditions that would make refinancing unavailable. Even if refinancing were sure to be available, as it almost always is for very highly rated borrowers, the rate the company would have to pay on the refinancing is uncertain.

For this reason, which I regard as very sensible, the typical pattern in the United States has been that businesses investing in plant and equipment seek to do so by issuing long-term bonds. In the United States we have had a very well functioning corporate bond market, with fixed rates of interest extending out to 20 and 30 years for many borrowers and even 40 years, which is the typical maturity for which the telephone company borrows. The existence of this long-term capital market is one of the major economic advantages we have over foreign countries. As a result of the experience in which holders of long-term bonds have had such major losses in their portfolios in recent years, however, fewer and fewer of the traditional lenders in long-term markets—like life insurance companies and pension funds, not to mention individuals—are willing to buy these long bonds.

Hence the supply is shrinking. The difficulty then is that the U.S. Treasury, which years ago issued only negligible amounts of long-term bonds each year, is now issuing a very large amount each year. Last year, for example, the U.S. Treasury issued $14 billion of long-term bonds. The private business that wants to put up a new plant then goes into the market, and it finds a more limited supply of long-term funds. Some borrowers, of course, are able to pay up, and do issue long-term debt at the higher interest rate that is caused by the increased Treasury borrowing. The problem is that many borrowers are not able to do that.

If a business that wanted to put up a new plant and finance it at long-term finds that long-term finance is either unavailable or too costly, it can do one of two things. It can forego the plant altogether, so that private capital formation is reduced, or it can take the risk and go ahead and finance at short-term, even though it is doing long-lived investment. Either way, there is a problem.

If we look at what has been happening in the U.S. economy in recent years, we see that both kinds of responses have occured. Our rate of capital formation is down, and I believe that these factors are in part the reason. Similarly, the corporate sector's balance sheet is becoming more and more precarious each year, regardless of which measure of corporate liquidity or balance sheet health we

look at. So either way, whether the investment gets passed by altogether or whether it gets done but financed at short-term rather than long-term, there has been a harmful effect.

Mr. ANTHONY. Thank you very much. I yield back my time, Mr. Chairman.

Chairman ROSTENKOWSKI. If there are no further questions, we thank you very much Professor Friedman.

Mr. FRIEDMAN. Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. The Chair wants to welcome to the committee Mr. John Benson. If you will identify yourself for the record, you may proceed with your testimony.

STATEMENT OF JOHN BENSON, VICE PRESIDENT, LEO BURNETT CO., CHICAGO, ILL.

Mr. BENSON. Thank you, Mr. Chairman. It is a pleasure to have the opportunity to appear here on behalf of U.S. savings bonds.

I am John Benson, vice president and senior account supervisor at Leo Burnett Advertising Agency, the vounteer agency for U.S. savings bonds. I have handled the advertising for the past 25 years.

As the volunteer agency we feel there is an urgent need to improve the bond product for the following reasons: One, to be more competitive with other forms of savings in order to attract new customers; two, to curb the drain—about $15 billion in the last 3½ to 4 years—of low-cost money that the Treasury has to replace with more expensive money; three, to continue to be able to attract quality volunteer both to the Industrial Payroll Committee and the Council of the U.S. Savings Bonds Volunteers without which this program would be in deep trouble.

And a comment on that. About 82 percent of the bonds are sold through the payroll savings program and most recently the paid field staff of the bond program has been reduced by about 30 percent, which makes it more important to attract quality volunteers. And if the product is not a suitable product that they believe in, I think the trouble in attracting these will be compounded.

Fourth, to make available to people a product that has a fair return and also has benefits that most other savings instruments do not have; namely, least costly to start. For example, you can start for as little as $3.25 a payday, most automatic through the payroll deduction plan and the safest because it is guaranteed by the U.S. Government.

Fifth, because all advertising for bonds is on a donated basis through the Advertising Council it competes for time and space with all other Council campaigns which in a sense makes us create copy that appeals to two consumers—one, the key people in media who make decisions as to which public service message will run and, two, meaningful copy that will persuade people to consider and purchase bonds.

Sixth, for example, if you work on an assembly line and you have five kids and a mortgage, how else can you save if they do not take it out of your paycheck?

Finally, in my opinion unless the bond product is improved I think it stands a good chance of going down the drain because it

could lose Advertising Council support plus it could fail to attract quality volunteers who are really the backbone of the program.

I think the feeling of people was summed up by the New York Daily News yesterday in a headline on an article that says "Hooray. Rates on U.S. Bonds to Rise." Apparently it is a little premature, but I think it is the feeling of people in the bond program. Thank you.

Chairman ROSTENKOWSKI. Thank you, Mr. Benson. Are there any questions?

[No response.]

Mr. CONABLE. Thank you very much.

Chairman ROSTENKOWSKI. If not, thank you very much for your testimony, Mr. Benson. We thank you for joining us.

This completes the committee's public hearing.

The committee will stand adjourned, and will resume at 2 p.m. on another matter.

[Whereupon, at 11:15 a.m., the hearing was adjourned.]

[The following was submitted for the record:]

STATEMENT OF THE NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS

The National Retired Teachers Association and the American Association of Retired Persons, together representing some 13 million persons, have long pressed for the establishment of market-oriented rates for all savings instruments but particularly for savings bonds and passbook savings. These two categories are probably the ones most favored by the elderly because of their liquidity.

We are therefore pleased to endorse the Treasury's proposal to establish a new type of savings bond with a market-determined rate of interest. This should provide an incentive for savers to buy and hold bonds in place of the disincentives to do so that have existed for at least the last decade. It should also provide increased equity for those who have bought and kept bonds during the long period of high inflation when high interest rates were available on other instruments. The elderly are probably disproportionately represented in that group.

We realize that the Treasury's proposal is not motivated by concern for bondholders but rather by concern to recapture a market for its debt securities that was fast vanishing. Although the move is long overdue, nevertheless it is welcome. Its realization will leave passbook accounts as the other savings instrument on which rates are set too low. We could hope that the thrift and banking institutions which so strongly resist market-related rates for passbook accounts would learn from Treasury's experience but, unfortunately, there is no evidence of this as yet.

STATEMENT OF JAMES D. ROBINSON III, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, AMERICAN EXPRESS CO., AND NATIONAL CHAIRMAN OF THE U.S. COUNCIL ON SAVINGS BOND VOLUNTEERS

As National Chairman of the U.S. Council for Savings Bond Volunteers, I fully support the Treasury Department's proposal establishing a flexible yield Savings Bond for consumers. Small savers deserve a fair investment alternative, backed by the credit of the United States, which the present product does not provide.

Swift Congressional approval of the legislation is essential to provide small savers with this investment alternative and to achieve the Council's primary objective: to increase the rate of personal savings in this country.

This legislation is urgently needed for two important reasons: First, it will enhance the attractiveness and competitiveness of Savings Bonds; and second, it will help lower the sky rocketing deficits that are contributing to excessively high interest rates and inhibiting economic recovery.

The Savings Bond Program provides an easy and effective way for small investors to automatically save through payroll deductions. The Bonds they purchase are frequently set aside to finance children's higher education or to augment retirement benefits. The Program also offers these individuals a unique package of advantages:

tax deferral benefits, total safety for principal from fluctuation in market value, and the ability to save in small amounts.

Last year, nine million people purchased over 70 million Savings Bonds worth $3.2 billion. Unfortunately, redemptions exceeded sales by $8.7 billion in 1981. Obviously, some savers are well aware of alternative investment opportunities with higher yields. Others through patriotism, remain loyal Bond holders.

It is precisely for these reasons that the Savings Bonds product must be improved. With a higher and more competitive rate of return on Savings Bonds, small savers would again purchase Bonds in greater volume. Many savers prefer investing in Savings Bonds because of the security they provide and the ease of purchase and redemption. Savings Bonds are guaranteed against market risk and loss, theft or destruction. In addition, Savings Bonds are not subject to state and local taxation and Federal tax is deferred until the Bonds are cashed.

Savings Bonds play major role in debt management. This year the government will pay more than $100 billion in interest alone on the $1 trillion national debt. Savings Bonds help the government meet this obligation in a cost-effective manner; the $67 billion in outstanding Bonds is $67 billion the government does not need to borrow in the public debt markets.

Clearly, the small saver deserves a fair alternative investment product from the U.S. Government. The viability and integrity of the Savings Bonds Program depend on it. More participation means higher sales, and higher sales mean greater savings for all.

Mr. Chairman, I strongly urge the Committee to report the Treasury proposal favorably and to seek early consideration of this measure by the full House. I am grateful to you for allowing me to submit this statement. My fellow Volunteer Chairmen from around the country and I are available to work with the Committee to ensure quick Congressional approval of the proposal.

AMERICAN STANDARD, INC.,
New York, N.Y., April 22, 1982.

Hon. DANIEL ROSTENKOWSKI,
Chairman, House Ways and Means Committee,
Rayburn House Office Building, Washington, D.C.

DEAR CONGRESSMAN ROSTENKOWSKI: I have personally endorsed annual payroll U.S. Savings Bond Campaigns throughout our Company and have supported their promotion in the industrial community for many years.

In my opinion the present economic climate in our country makes it more important than ever to encourage greater individual participation in the purchase of U.S. Savings Bonds. This can only be accomplished if prompt steps are taken by the Congress to provide for a flexible yield bond which will enhance the attractiveness and competitiveness of savings bonds for individuals who wish to invest in them.

I urge your full support of the legislation recently submitted to the Congress by the Treasury Department providing for a flexible U.S. Savings Bond. This legislation must be acted upon expeditiously to ensure productive results in the sale of U.S. Savings Bonds this year.

As Chairman of the Committee your quick action and continuing support is requested.

Very truly yours,

WILLIAM A. MARQUARD,
Chairman, President and Chief Executive Officer.

STATEMENT OF C. LOWELL HARRISS, NEW YORK, N.Y.

MANAGEMENT OF THE FEDERAL DEBT

Legal restraints on interest rates and permissible characteristics of United States debt obligations will reduce the ability of Treasury officials to obtain the best terms possible under market conditions as they develop. The persons responsible for marketing new issues of debt (including, of course, refundings) will have alternative opportunities which change constantly. The relative yields—the costs to taxpayers—will inevitably differ from time to time. So will the other results of borrowing.

The very wisest of judgments as to what would be best at any one time, say, at mid-1982 when the passage of a new statute is under consideration, would soon become outdated. From month to month conditions might change only imperceptibly, but shifts of significant importance can also occur. Congressional processes

cannot be expected to permit statutory revisions whenever economic conditions change.

Markets for debt of high quality are highly competitive. Differences in yields will reflect variations in conditions of supply and demand as they result from the myriad of factors which affect lenders and borrowers in this country and over the world. Lawmakers have tried to anticipate the future by legislating maximum interest rates and duration limits on Federal issues. Such efforts presume a knowledge of the future which no one can possess. Congress may prescribe now. Doing so, however, will assure that Treasury actions later in conforming to those rules will sometimes fail to represent what is best at the time. In concluding that civil servants acting from month to month will do better if free from legislative dictates, one does not assert disrespect for elected officials. One does assert that conditions change more frequently that statutes will be revised.

There was a time when I believed that the Treasury could exert a constructive anticyclical force through debt management. By increasing or decreasing federal demands on one as against another portion of the market (long- versus short-term) relative supply-demand and interest rate elements might be modified to benefit the economy. Today, humility and caution lead me to question the potentials. I question the possibilities of doing good rather than harm—over a not very long run; the realities of the world, taking account of the actual operations of markets, are too complex for any statutory restrictions to be helpful.

One condition, however, does command attention. Huge amounts of federal debt are permanent. Net debt reduction will be impossible in the foreseeable future. Therefore, the funding of more of the debt into long-term issues would reflect the underlying economic reality. Congressionally imposed restrictions on long-term borrowing—explicit or indirect—will obstruct movement toward a goal which would conform the debt structure a little more closely to the facts of American economic life. A deliberate policy of gradually lengthening the average of the debt would not necessarily involve large and disturbing alterations in the pattern of the debt structure. The cumulative results over, say, a decade could be more than insignificant.

An expression such as "conforming the debt to the reality of its permenance," admittedly lacks precision, "Churning" in the short-term market does not necessarily mean distortion of relative interest rates or serious avoidable costs of refinancing. Yet to some degree the results from massive short-term (highly liquid) debts will involve "artificial" elements; wasteful disturbances are inevitable, not necessarily on every turnover of short- and medium-term debt but on some occasions.

Almost any offering of long-term debt can be expected to bring forth criticism that "The Treasury will take funds away from the financing of housing and other long-term projects." Long-term interest rates, it will be said, are going to be higher; the change will produce injury that could be avoided. However, except for marginal effects that should be rather transitory, the net differences seem to me likely to be small. Much depends upon magnitude relative to time. Some students of debt markets who are closer to operations than I may find grounds for predicting greater effects on long-run interest rates through the years. It is not, however, the total of borrowings that are the dominant influences over time? Any concentration of borrowings in the short end of the market will tend to raise interest rates there and draw funds from the market for longer-term debt. Competition will operate.

Debt structure and debt management raise issues of the inflationary potential of Federal financing. The subject calls for discriminating concern. Recent discussions reflect increasing awareness of the crucial, as distinguished from the nonessential, elements of Federal borrowing. A mass of short-term debt does not require "extra" money creation at times of refinancing. Yet we must recognize the likelihood of temptations; they may not always be resisted. One argument for lengthening the average maturity is that doing so will reduce the risk of the inflationary creation of money.

STATEMENT OF BRUCE DAVIS JACKSON, CPA, NEW BRAUNFELS, TEX.

The public debt is not an asset to be managed, it is an obligation to be repaid. The slogan, "Don't worry about the national debt—we owe it to ourselves!", is foolish and untrue. Some of us owe it to the rest of us. The public debt arose because our thrifty citizens, who had saved some of their earnings, loaned their capital to the rest of us so that we could consume their capital and enjoy the "benefits" of deficit spending—inflation and an expanding central government.

The lenders, in return for their patriotic sacrifice, have typically been repaid with units of fiat paper currency which provide them less purchasing power than they initially loaned us. That is dishonest, simply theft.

I suggest that we adopt a plan to repay the public debt, either through tax increases set aside for repayment, or through the liquidation of the Federal Government assets. I expect that the lenders to whom we owe the pubic debt would willingly surrender their rights to receive paper in exchange for real assets. Since the U.S. owns about 750 million acres of land and about 250 million ounces of gold and our public debt is about $1 trillion, we could offer to redeem our debt at $1,000/acre or $1,000/ounce, and completely extinguish the debt. By saving interest costs of about $70-100 billion annually, this would balance our budget and eliminate the need for future borrowing.

It would also be honorable and just.

MARIETTA, GA., *April 20, 1982.*

Congressman DANIEL ROSTENKOWSKI,
Chairman, House Ways and Means Committee,
Rayburn House Office Building, Washington, D.C.

DEAR CONGRESSMAN ROSTENKOWSKI. I thought you as chairman of the Ways and Means Committee might like an opinion from one who serves as state and Metro Atlanta chairman for the 1982 U.S. Payroll Savings Bond Drive.

The variable yield savings bond is needed as quickly as it can be passed. It is needed if we are to keep selling the bonds.

I have worked on payroll savings bonds under both Democratic and Republican White House leadership, and have seen the importance of this portion of the Government financing program regardless of which party is in office.

From the Savings Bond people I've learned of your support of the flexible yield bonds and of your strategy for getting them approved. This is my way of pointing out the benefits of the earliest possible passage—for without it sale of bonds will be seriously curtailed.

Thank you for your consideration.

Sincerely,

R. B. ORMSBY.

STATEMENT OF U.S. LEAGUE OF SAVINGS ASSOCIATIONS

The U.S. League of Savings Associations [1] strongly opposes the most recent Treasury recommended changes in the rate of interest paid on U.S. government savings bonds. Just eighteen months ago the Treasury, after appealing to Congress, was granted authority to make their savings bonds competitive by increasing the interest rate on these bonds by up to one percent during any six-month period. Now the Treasury argues that a competitive interest rate is not sufficient and that it should be protected against any downside market risk. What change will be sought next year—100 percent market, or premiums? As private financial competitors serving these same savings customers, savings and loan institutions are deeply concerned with this latest Treasury proposal which we feel could transform the savings bond instrument into a dominant competitive force with our savers.

Over the years our institutions have always been faced with Federal government competition for the individual's private savings dollar. However, the latest Treasury proposal is particularly threatening since U.S. savings bonds already have strong marketing advantages. They are free of state or local taxation, available in low minimum denominations ($50), marketed in sophisticated payroll deduction and bond-a-month plans, and Federal taxation is deferred until maturity or redemption. But, above all, their purchase is motivated by considerations other than interest

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[1] The U.S. League of Savings Associations has a membership of 4,100 savings and loan associations representing over 99 percent of the assets of the $650 billion savings and loan business. League membership includes all types of associations—Federal and state-chartered, stock and mutual. The principal officers are: Roy Green, Chairman, Jacksonville, Fla.; Leonard Shane, Vice Chariman, Huntington Beach, Calif., Stuart Davis, Legislative Chairman, Beverly Hills, Calif., William B. O'Connell President, Chicago, Ill.; Arthur Edgeworth, Director, Washington Operations; Glen Troop, Legislative Director; and Phil Gasteyer, Associate Director, Washington Operations, League headquarters are at 111 East Wacker Drive, Chicago, Ill. 60601. The Washington office is located at 1709 New York Avenue NW., Washington, D.C. 20006. Telephone: (202) 637-8900.

rate return, i.e., patriotism. All these advantages, plus a competitive variable interest rate, will make the savings bonds program a formidable threat to private capital formation in general and savings and loans in particular.

As a result of the last two and one-half years of high interest rates from spiraling Federal deficits, savings and loan institutions' earnings from long-term, low-yielding mortage assets have been seriously weakened. At the same time that out-side forces are driving up market costs, liability deregulation is exacerbating our own industry costs. In other words, as savings and loan liabilities are being restructured, outside market forces and competitors are applying tremendous pressure to attract our savings dollars. Therefore, if the Treasury is allowed this highly competitive variable rate savings bond instrument, a substantial number of our existing savers would unquestionably be attracted by this type of savings instrument.

The chief objective of Federal debt management policy is to limit the conflict between Federal government deficits and private capital formation. This conflict can never be eliminated totally, but the Treasury should always select its new securities in an effort to mimimize the interference with private capital formation and investment. The latest Treasury proposal, combined with the most recent frightening deficit figures of over $180 billion for fiscal 1983, will certainly aggravate rather than minimize this expected conflict.

The variable savings bond instrument also raises serious administrative questions. The savings bond interest rate is indexed to 85 percent of the average market yield on 5-year Treasury securities. This continuing rate fluctuation will cause a great deal of difficulty as institutions redeem maturing bonds for their customers. Instead of utilizing a simple table to determine earnings on the bond, a rather complicated calculation will be required assuming all the information is available. The variable rate bond will, therefore, create enough additional complexity that many participating institutions in the current U.S. government savings bond program might very well opt out.

Therefore, with savings flows at our institutions reaching an all-time low, money costs increasing at unprecedented rates and mortgage lending at a standstill, the U.S. League of Savings Associations urges the members of the Way and Means Committee to reject this variable rate savings bond Treasury proposal as inconsistent with a proper Federal government-private sector competitive balance.

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